Mini Symposium on Foreign Direct Investment in India

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Foreign direct investment to and from emerging economies has experienced significant growth over the past 2 and a half decades. In 2014, these economies absorbed 59% of cumulative global FDI inflows and accounted for 39% of the world's total FDI outflows. The changing pattern of FDI inflows and outflows is expected to have significant impacts on the economies of developing countries in the years to come. FDI inflows have enormous potential to influence economic performance in host countries not only directly by providing access to modern technologies, but also indirectly through spillovers. In the current era of globalization, multinational enterprises (MNEs) have become powerful economic players as the primary vehicle of FDI. Out of 37 million listed companies and investors worldwide, 147 MNEs controlled 40% of the world's economic value. By virtue of their size; technological prowess; and internalized markets for skills, capital, technology, and brands; MNEs can enable developing countries to acquire updated technologies and access international networks to expedite industrialization and economic growth, create decent jobs, and reduce poverty. The United Nations has identified the revitalization of global partnerships for development as one of its Sustainable Development Goals. FDI flows figure prominently in this goal as a source of much-needed capital, technology, and market access for host countries.

There is a contrasting view claiming that as economic wealth becomes increasingly concentrated in MNEs, it may not be possible for the global economy to develop in a sustainable way. MNEs have the potential to destroy sustainable consumption and production patterns, leading to damaging economic, social, and environmental impacts. For instance, MNEs can support the creation of monopolies and oligopolies that crowd out domestic investment. Another concern is that MNEs will introduce technologies in host countries that destroy jobs, perpetuate inequalities, and generate pollution.

Thus, a pertinent question to ask is whether FDI is a vehicle for promoting sustainable development or a threat to such development. The existing literature appears to be ambiguous and inadequate to answer this question. While the literature on FDI is substantial, not enough is known about the impacts of FDI across different dimensions. Most studies, particularly in the context of developing countries, remain beset by a lack of quality data and weak methodology. In addition, the existing literature focuses primarily on FDI inflows, while issues surrounding outward investment are relatively less known.

To encourage FDI-related studies in developing countries, an international conference on Leveraging FDI for Sustainable Economic Development in South Asia: Evidence, Challenges, and Prospects was organized by the Asia Research Centre of the Copenhagen Business School in October 2015. Five studies, all pertaining to India, have been selected for the mini symposium presented here. Each of these studies falls into one of three broad categories covering the economic, social, or environmental aspects of development.

On the economic front, improving industrial competitiveness is central to raising the underlying growth rate of an economy. Competitiveness means deepening the technological and organizational skills of local firms, including research and development (R&D) efforts, enhanced efficiency in the use of resources, and performance in national and international markets. Two studies published in this symposium analyze the impacts of foreign ownership on technological spending and international competitiveness. Aggarwal links foreign ownership with the mode of technology sourcing used by firms. She argues that the spillover effects of foreign ownership remain limited if domestic firms depend on their parent organization for acquiring technology. She analyzes the intensities of local R&D efforts and the technology imports of local and foreign firms in a comparative analytic framework. Propensity score matching analysis reveals that foreign companies, particularly those with majority stakes, spend less on R&D and more on acquiring technology from their parent organization than their local counterparts. While focusing on the export behavior of domestic and foreign firms, Ghosh and Sinha Roy find that foreign ownership does not significantly enhance the export intensity of Indian manufacturing firms. Rather, firms enhance their international competitiveness from a mix of imported raw materials, foreign technical know-how, and local R&D.

The study by Sharma focuses on the social dimensions of FDI. She investigates whether FDI inflows in an industry increase plant-level employment, average wages, and skilled labor. Theoretically, foreign ownership provides host countries with access to knowledge, which, if absorbed by domestic workers, enhances the human capital stock. The effects spill over to domestic firms through the training of suppliers, imitation, labor mobility, and formal and informal transfers of know-how to domestic workers. This should lead to an increase in average wages for workers in both domestic and foreign firms. Further, if there are complementarities between foreign inputs accompanied with foreign investment and the skills of workers, an increase in FDI should also lead to an increase in demand for skilled workers. The results suggest that there are strong market reallocation effects as the share of foreign ownership increases in an industry, while a critical mass of FDI is likely required to influence the demand for and pool of skilled workers in an industry.

Concerning the environmental dimension, Kathuria finds that MNEs are not investing in polluting industries in India. His study tests the pollution haven hypothesis—the possibility that investors seek out jurisdictions with fewer regulatory requirements and therefore cheaper operating costs—by focusing on the impacts of environmental governance using data for 21 Indian states. The results do not find any evidence in support of the pollution haven hypothesis. Other market and infrastructure-related variables are more important in influencing foreign firms' location decisions in India than a state's environmental stringency.

The literature on outward FDI from emerging economies has also proliferated of late. India's outward FDI stock registered a quantum jump over the last decade from only about $25 million annually during the early 1990s to $241 billion in 2013. Sasidharan and Padmaja investigate how firms in a resource-poor country invest internationally by analyzing the role of both internal and external financing constraints of Indian manufacturing firms in determining their outward FDI decisions and number of foreign affiliates. Their empirical findings confirm the importance of internal funds in firm investment decisions and the magnitude of such investments. Firms that are large, highly productive, and export oriented are more likely to invest abroad.

The studies presented here are methodologically rigorous. We believe that both academics and policy makers will find them useful. Taken together, they have demonstrated that the benefits of globalization and FDI are not automatic. Improved infrastructure, stronger institutions, and expanded capabilities among domestic firms are needed to promote both inward and outward FDI flows and exploit the opportunities created by globalization. Inward FDI flows must be matched with host country policies to facilitate the spillovers and linkages needed to ensure that FDI contributes to structural transformation and growth.

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